EPRA
EUROPEAN PUBLIC
REAL ESTATE ASSOCIATION

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Business in Europe: Framework for Income Taxation (BEFIT)

Introduction

The European Public Real Estate Association (EPRA) is the voice of Europe's listed real estate companies and with more than 290 members (companies, investors, and their suppliers), EPRA represents over 840 billion EUR of real estate assets (European companies only) and 95% of the market capitalisation of the FTSE EPRA Nareit Europe Index.

While EPRA corresponds to the policy goals at the core of the BEFIT proposal and sees benefits in some of its measures, we are concerned about making the rules mandatory for certain large companies. Specifically, enforcing BEFIT rules on Real Estate Investment Trusts (REITs) falling within the scope could introduce more complexity and uncertainty, potentially disrupting the current European REIT regime's landscape applied in 13 jurisdictions of the EU. Therefore, we welcome the opportunity to provide a note on the current work done by the EC, compiling industry insights to facilitate discussions at the Council level.

REIT regime concept in Europe

REITs are guardians of our cities' high-quality assets, covering all types of real estate assets, from offices to retail, and increasingly healthcare and retirement facilities. They help communities grow, thrive, and revitalise, while also providing an investment opportunity that makes it possible for everyday citizens as well as large institutional investors to benefit from valuable real estate, dividend-based income, and total returns. As societies in Europe are facing challenges to provide for their rapidly ageing populations, REITs play a crucial part in providing retirement security to millions of people, by offering long-time investors like pension funds and insurers stable and highly competitive assets to invest in. Furthermore, they are significant contributors to GDP and society as they represent hundreds of thousands of jobs on our continent. Currently established in 13 EU Member States, the introduction of REIT legislation by national governments has always been seen as an opportunity to attract new sources of capital into the local real estate market in a more open, transparent, liquid, and advantageous form of investment.

Real Estate Investment Trust (REIT) is defined as *"a widely held company, trust or contractual or fiduciary arrangement that derives its income primarily from long-term investment in immovable property (real estate}, distributes most of that income annually and does not pay income tax on income related to immovable property that is so distributed."* [1]

The fact, the REIT vehicle does not pay tax on that income is the result of tax rules that provide for a single level of taxation in the hands of the investors in the REIT (with corresponding withholding tax obligations imposed on the REIT with respect to its distributions to foreign investors).

Despite these common features, there may be differences between countries as regards how REITs are structured and how the tax exemption of the income is provided. In some countries, REITs were developed using the tax rules generally applicable to trusts and companies; in others, a specific REIT tax regime has been adopted.

The specific tax mechanisms that ensure REITs are tax-exempt can vary from country to country and can include, for example, rules that allow the deduction of REIT dividends or distributions; tax exemption of only the part of the REIT's income distributed within a specific period; tax exemption of a REIT that meets certain conditions or rules that allocate income to investors rather than to the REIT itself. In addition, REITs are increasingly investing across borders, including in jurisdictions that do not recognise a REIT status, resulting in full tax liability there.

[1] OECD's definition of a REIT used for the purpose of the OECD Model Tax Convention.

The structural nuances and tax exemptions associated with REITs exhibit diversity. The divergence in how various Member States integrate REITs into their tax frameworks underscores the complex global landscape, in such a way that the **determination of whether a REIT is subject to BEFIT rules may give rise to different interpretations and presents a risk of not being uniform across all EU Member States.**

Overall assessment

Key concerns within our sector regarding the following elements:

- Specific tax mechanisms ensuring REITs' tax exemption vary from country to country, which can lead to an uneven application of BEFIT rules. Linked to that, due to the notion of 'subject to tax' outlined in the Directive and the variety of tax mechanisms for achieving exemptions in different European REIT regimes, this may result in varied interpretations among Member States, increasing uncertainty, and uneven application of the rules.

- The thresholds set out in the Directive to be part of the BEFIT group also introduce discrepancies and would impose additional burdens and complexities.

- The current discussion around Article 48, para. 2 of the Directive can prevent Member States from enforcing national tax specificities applicable to REITs.

In-depth analysis: uncertainties surrounding the application of BEFIT rules to REITs

As a preliminary remark, as the BEFIT proposal builds on the OECD/G20 international tax agreement on a global minimum level of taxation, EPRA would like to recall the discussions with the OECD which have highlighted the unique characteristics of real estate investment vehicles (REIVs) and provided a carve-out for this specific sector. This has led to the exclusion of real estate investment vehicles from the scope of the Pillar Two agreement approved on 14 December 2021 by the OECD/G20 Inclusive Framework on BEPS, and to the subsequent Directive adopted by the Council.[2]

- **Tax status and scope of the Directive**

The existing ambiguity in the wording of Article 2 has prompted numerous stakeholders to question its precise scope. Under this Article, the rules of the Directive are to be applied to a company, along with its permanent establishments in other member states, which are *"subject to one of the corporate taxes listed in Annex II or to a similar tax subsequently introduced."*

The notion of being "subject to tax" introduces uncertainty. The International Bureau of Fiscal Documentation (IBFD), in their comprehensive report on the BEFIT Directive[3], points out that it is unclear whether this should encompass companies that are tax-exempt or have the option to be. In contrast, other corporate tax Directives, such as the parent-subsidiary Directive or the interest and royalty Directive, explicitly include wording to cover companies "without the possibility of an option or of being exempt"[4] or companies that are not exempted.[5]

As mentioned above, the methods by which REITs achieve tax exemption vary. While some operate under a tax transparency regime, others may be subject to corporate income tax with a de facto zero or near-zero taxable basis on real estate results. Adding to the complexity, cross-border investments made by REITs, extending into jurisdictions that do not acknowledge REIT status, expose these entities to full tax liability there.

The current uncertainty permits various interpretations, making it challenging to anticipate the potential impact of the proposed rules on business operations and real estate markets in EU member states for REITs falling within the revenue threshold.

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[2] Council Directive (EU) 2022/2523 of 14 December 2022 on ensuring a global minimum level of taxation for multinational enterprise groups and large-scale domestic groups in the Union.

[3] https://www.ibfd.org/sites/default/files/2023-10/2023.10.12-befit_an-initial-assessment-vf.pdf

[4] Council Directive 2011/96/EU of 30 November 2011 on the common system of taxation applicable in the case of parent companies and subsidiaries of different Member States, art. 2(a)(iii).

[5] Council Directive 2003/49/EC of 3 June 2003 on a common system of taxation applicable to interest and royalty payments made between associated companies of different Member States, art. 3(a)(iii).

- **Unclear consolidation within a BEFIT group**

The various rules pertaining to the formation of a BEFIT group add complexity. The BEFIT group is indeed confined to the European subset of entities that meet the 75% threshold, as outlined in Article 5. Consequently, it is unclear how the consolidation of BEFIT rules can be executed when applying rules that do not encompass all the companies forming a group.

Despite the BEFIT proposal's intention to simplify corporate tax procedures, the ambiguities outlined could lead to an unreasonably complex outcome for REITs and disrupt their business operations.

- **Article 48, para. 2 of the Directive**

Considering DG TAXUD's comments at the recent EESC hearing in January, it seems that the current wording of Article 48, para. 2 of the Directive has prompted the objective of narrowing its scope. While the current wording allows Member States some room for maneuver, making the provision stricter might prevent member states from enforcing national tax specificities applicable to REITs, reinforcing the need for a carve-out provision.

In light of those elements, we would like to make **two recommendations:**

1. While EPRA acknowledges the merits of certain measures contained in the proposal, we believe that, due to the reasons outlined in this note, **REITs falling within the scope should have the option to voluntarily adhere to these rules rather than be mandated to do so.**
2. Alternatively, **EPRA would see merit in granting the possibility for Member States to exclude companies under a special regime from the scope**. Member States, possessing a more profound understanding of their national tax systems and REIT structures, would be in the best position to determine whether these entities should fall within the scope of the BEFIT Directive. This holds significant importance in light of the comments made above on the potential restriction of Article 48, para. 2.

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We trust that our feedback will aid in fostering productive debates and we remain entirely at your disposal to discuss these issues in greater detail. Should you need any other information, please contact: publicaffairs@epra.com